Euro wrap-up

Overview

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- Bunds made losses as German inflation was revised higher but the ECB account noted broad agreement that the Governing Council should be ready to ease monetary policy further.
- Gilts made significant losses as the BoE again judged that UK banks were sufficiently well-capitalised to cope with a no-deal Brexit.
- Friday will bring data for euro area industrial production and Spanish inflation.

Daily bond market movements

Bond	Yield	Change*
BKO 0 06/21	-0.729	+0.006
OBL 0 04/24	-0.623	+0.022
DBR 0¼ 02/29	-0.262	+0.045
UKT 1½ 01/21	0.612	+0.040
UKT 1 04/24	0.634	+0.070
UKT 1⅝ 10/28	0.837	+0.079

*Change from close as at 4.30pm BST.
Source: Bloomberg

Euro area

ECB account suggests July easing is possible

The account of the ECB's June policy meeting, released today, made clear that further near-term easing of the monetary stance is now highly likely but that the timing and composition of the next steps remains uncertain. Last month, the ECB agreed the parameters of the forthcoming TLTRO-III liquidity operations, and extended its forward guidance to state that rates are expected to remain at current levels or below "at least through the first half of 2020". According to today's account, those measures were judged to "provide the necessary monetary accommodation for inflation to move towards" the ECB's target. However, the policymakers recognised that the downside risks to the economic outlook from events abroad had increased, and that they would need "to act in case of adverse contingencies". As such, there was "broad agreement" on the Governing Council that it should"be ready and prepared to ease the monetary policy stance further". The account added that adjustments to all instruments – including a further extension of forward guidance, the recommencement of net asset purchases, and further rate cuts – would be considered in such circumstances. But the relative merits of each individual policy instrument was not discussed.

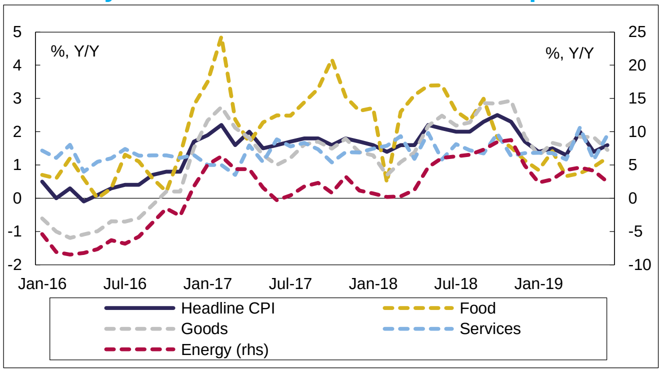
But we maintain our call for a September rate cut

Today's account was also unclear as to precisely what would now justify further policy easing. In Sintra, Mario Draghi suggested that the mere failure of the economic outlook to improve materially would suffice to justify further action. If so, easing in July would seem perfectly possible. But ECB Executive Board member Benoît Cœuré, who today appeared to downplay the importance of the recent deterioration in market-based measures of inflation expectations, recently suggested that a further deterioration in the economic outlook would be required to prompt further easing. If so, and given the mixed nature of recent data (today's revised German inflation figures being a case), we continue to think that the next policy announcement on 25 July will only see the Governing Council amend its guidance to make clear that further easing is imminent. When the ECB's forecasts are subsequently updated in September, the Governing Council would then be able to calibrate more precisely its easing package, which we expect to include a 20bps cut in the deposit rate to -0.60%; the introduction of a tiered rate framework; and an increase in the issue and issuer limits on the QE programme to 50% to make clear that the recommencement of net asset purchases would occur in the event of a further deterioration in the outlook.

Final German inflation surprises to the upside

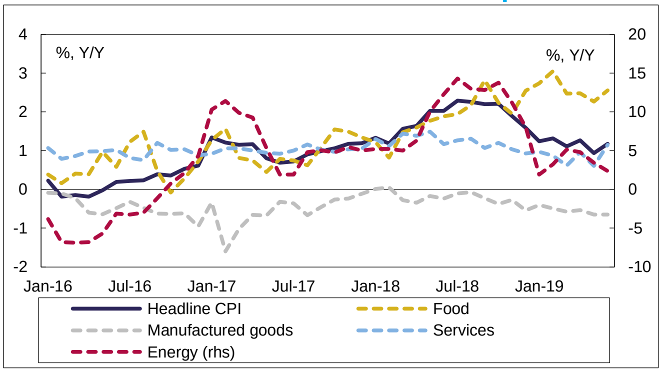
The final June inflation figures from the largest two member states, published today, might have reduced marginally the case for a rate cut as soon as this month. Certainly, there was an unusual upwards surprise to the German figures, as the headline EU-harmonised inflation rate was revised up from the flash release by 0.2ppt to 1.5%Y/Y, also 0.2ppt higher than the May reading. Admittedly, the preliminary HICP figures had been somewhat at odds with the national inflation numbers. Indeed, the headline rate on the national measure was today confirmed at 1.6%Y/Y, unchanged from the flash estimate and also up 0.2ppt from May. This

Germany: Headline CPI and selected components*



*National measure. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

France: Headline CPI and selected components*



*National measure. Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

was due to higher inflation of services (up 0.7ppt to 1.9%Y/Y), as package holiday prices again provided a boost (up 15.2ppts to 6.1%Y/Y) and food (up 0.3ppt to 1.2%Y/Y). In contrast, energy inflation fell 1.7ppts to 2.5%Y/Y. So, today's release showed that German core inflation rose more than the headline rate, up 0.4ppt to 1.6%Y/Y.

Final French CPI confirms increase in June

There were no surprises from the final inflation figures from France, which confirmed the acceleration seen in the preliminary release. Indeed, the EU-harmonised and national rates of headline CPI aligned with the 0.3ppt increase in June's flash estimate to 1.4%Y/Y and 1.2%Y/Y respectively. Like in Germany, the pickup in the French national measure principally reflected higher services inflation (up 0.6ppt to 1.2%Y/Y), on the back of higher transport prices (up 3.0ppts to 1.5%Y/Y). So, while deflation in manufactured goods was unchanged on the month at -0.7%Y/Y, today's release showed a notable pickup in core French inflation in June, by 0.4ppt to 0.9%Y/Y, the highest rate since August. Assuming the final results from Italy (due Tuesday) and Spain (due tomorrow) are unrevised – down 0.1ppt to 0.8%Y/Y and down 0.3ppt to 0.6%Y/Y respectively – today's figures imply an upwards adjustment to the euro area's inflation rate (data due Wednesday). We now expect headline CPI inflation of 1.4%Y/Y, upwardly revised by 0.2ppt from the flash estimate and also up 0.2ppt from May. In contrast, core CPI is likely to merely align with the preliminary release, which showed a sizeable 0.3ppt increase from May to 1.1%Y/Y.

The day ahead in the euro area and US

Tomorrow will bring euro area industrial production figures for May. With industrial output having increased in the four largest member states that month – and by an impressive 2.1%M/M in France – we expect aggregate production in the euro area (excluding construction) to have risen 0.8%M/M in May, underpinned by a strong rebound in the manufacturing sector. Nevertheless, this would represent the first monthly rise in four to leave output still down around ½%Y/Y and on average in the first two months of Q2 0.2% below the average in Q1. Friday will also bring final Spanish inflation figures for June, which are expected to confirm that the EU-harmonised rate fell 0.3ppt to 0.6%Y/Y, a more-than 2½-year low. In the US, tomorrow will see the release of just PPI figures for June.

UK

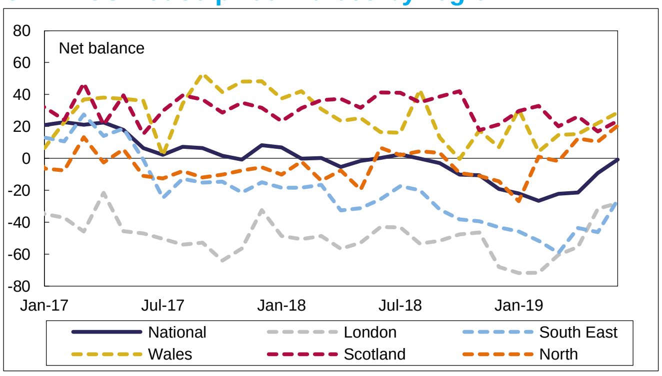
RICS suggests more stable housing market

In the UK, after yesterday's monthly GDP report for May came in marginally stronger than expected, today brought a slight upside surprise from the latest RICS housing market survey, suggesting some stability had returned at the end of the second quarter. Most notably, the survey suggested a modest increase in buyer enquiries in June – with the relevant index rising to its highest level since early-2016 – while the indicator for new instructions edged into positive territory for the first time in a year and the one for agreed sales was the highest since late-2016. And the survey suggested that sales expectations over the coming three months were broadly stable, while surveyors were more upbeat about the twelve-month horizon. Against the backdrop of rising demand and supply shortages, the survey also signalled a further improvement in the house price balance, up 8pts in June to -1, its highest level since September and more than 25pts above February's trough. While the improvement was widespread, there was a notable increase in the index for the South East (up 20pts in June) to suggest a slower pace of house price deflation in the region. Prices in London were also assessed to be falling at a more moderate pace. And the price index for the South West posted the first non-negative reading for a year. While today's survey suggests, for now, that the worst might be over for the housing market, and mortgage interest rates seem likely to fall further in response to recent market events, we wouldn't get too carried away. Consumer confidence remains weak and the persistent Brexit uncertainty will no doubt continue to weigh on the market for some time to come. Indeed, the no-deal Brexit that PM-in-waiting Boris Johnson keeps talking up would provide a massive blow to the sector which, today's survey suggests, is still now merely treading water.

The day ahead in the UK

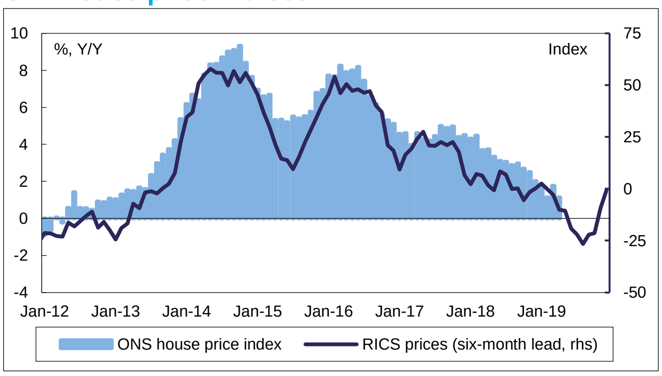
It should be a quiet end to the week in the UK, with no data of note due for release.

UK: RICS house price indices by region



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

UK: House price indices



Source: Thomson Reuters and Daiwa Capital Markets Europe Ltd.

European calendar

Today's results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
Germany	Final CPI (EU-harmonised CPI) Y/Y%	Jun	**1.6 (1.5)**	1.6 (1.3)	1.4 (1.3)	-
France	Final CPI (EU-harominsed CPI) Y/Y%	Jun	**1.2 (1.4)**	1.2 (1.4)	0.9 (1.1)	-
UK	RICS house price balance %	Jun	**-1**	-12	-10	**-9**

Auctions

Country	Auction
Italy	sold €3bn of 2022 bonds at an average yield of 0.49%
	sold €2.5bn of 2026 bonds at an average yield of 1.24%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's data releases

Economic data

Country	BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
EMU	10.00	Industrial production M/M% (Y/Y%)	May	*0.8 (-0.5)*	-0.5 (-0.4)
Spain	08.00	Final CPI (EU-harmonised CPI) Y/Y%	Jun	0.4 (0.6)	0.8 (0.9)

Auctions and events

Country	BST	Auction / Event
Italy	10.00	ECB's Visco & Italy's Tria speak in Milan
	14.00	Bank of Italy releases its Quarterly Economic Bulletin
UK	09.30	BoE's Vlieghe speaks in London

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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